KATALYST ADVISORS

Katalyst Kaleidoscope

January 2023: Tax and Regulatory Insights

SUMMARY OF CONTENTS

A. Income tax Highlights

1. Supreme Court[1]: Valuation for gift of listed shares under lock-in period to be made as unquoted shares for computation of Gift Tax

In the case of DCGT vs BPL Ltd, the assessee had gifted shares of listed public companies in the year 1993 which were held by Promoters and thus were under lock-in period at the time of gift. The Gift-tax Officer held it to be a deemed gift of Quoted Securities u/s 4(1) of the Gift Tax Act computing value of shares under mechanism prescribed for Quoted Securities.

The High Court and Supreme Court upheld levy of gift tax as per CIT(A), on value of gift computed for securities gifted as that of Unquoted Securities considering that there was a lock-in on the listed securities as on date of gift, which made them ineligible for trade and thus qualified as 'Unquoted Securities' under the Act.

Katalyst Comments:

Whereas Gift Tax and Wealth Tax have been repealed, this decision lays down an important ratio for valuation of listed securities which are under lock-in period and can be relevant for computation of fair market value of securities on transfer.

2. Mumbai ITAT: - Exemption u/s 47(xiiib) cannot be withdrawn on introduction of goodwill with credit to current accounts of partners of LLP post conversion of private company into LLP

In the case of Brizeal Realtors and Developers LLP[2], Tribunal held that the exemption u/s 47(xiiib) (which deals with exemption from capital gains on conversion of a Company to an LLP) cannot be withdrawn on introduction of goodwill with credit to current accounts of partners of LLP on admission of new partner post conversion of private company into LLP. Such introduction of goodwill in books of LLP post-conversion by credit to partners' current accounts does not amount to receipt by the shareholders of "any consideration or benefit, directly or indirectly, in any form or manner, other than by way of share in profit and capital contribution in the limited liability partnership" as the status as shareholder exists till the existence of company i.e. till the conversion. On and from the date of conversion, the partners of the LLP can no longer be regarded as shareholders, hence no violation of clause (c) of sec. 47(xiiib), which deals with consideration to shareholders of company upon conversion to LLP.

The Tribunal further held that there is no violation of clause (f) of the Proviso to section 47(xiiib) also, which deals with restriction on distribution of 'accumulated profits of the Company as on date of conversion'.

[1] [2022] 448 ITR 739 (SC)
[2] [2023] 146 taxmann.com 109 (Mumbai - Trib.)

3. Delhi High Court: Difference between ESOP option price and prevailing market price allowable as revenue expenditure

The Delhi High Court, in the case of PVR Ltd[3] held that the difference between the price at which stock options were offered to employees under ESOP and the prevailing market price of the stock on the date of grant of such options is a revenue expenditure and allowable as deduction under section 37(1) of the Income-tax Act, 1961. The High Court while interpreting section 37(1) added that the provisions of the aforesaid section permit deduction for the expenditure laid out or expanded and does not contain a requirement that there has to be a payout. If an expenditure has been incurred, provision of section 37(1) of the Act would be attracted; it is also pertinent to note that section 37 does not envisage incurrence of expenditure in cash.

In an ESOP, a company undertakes to issue shares to its employees at a future date at a price lower than the current market price. The employees are given stock options at discount and the same amount of discount represents the difference between market price of shares at the time of grant of option and the offer price. The expression 'expenditure' will also include a loss and therefore, issuance of shares at a discount where the assessee absorbs the difference between the price at which it is issued and the market value of the shares would also be expenditure incurred for the purposes of section 37(1) of the Act.

Katalyst Comments:

The Delhi High Court has followed the ratio laid down by Karnataka High Court in CIT vs Biocon Ltd [4]and Delhi High Court in case of P.CIT vs New Delhi Television Ltd[5] on deductibility of ESOP expenses being an ascertained liability.

4. Chennai ITAT: Revenue cannot change valuation method for Sec.56(2)(viib) (regarding justifying share premium) over variation in projected & actual figures.

The Chennai bench of ITAT in case of SB Industrial Engineering[6], allowed an appeal in assessee's favor and deleted the additions made on account of the difference between the fair market value of shares computed by the Revenue using Net Asset Value (NAV) method, as against the value computed by the Assessee using Discounted Cash Flow (DCF) method.

The assessing officer rejected the valuations submitted by the assessee under DCF method on the grounds that the projected cashflows and actual cashflows of the assessee for the assessment year were different.

[3] [2022] 145 taxmann.com 331 (Delhi)
[4] [2020] 121 taxmann.com 351 (Karnataka)
[5] [2018] 99 taxmann.com 401 (Delhi)
[6] [2022] 145 taxmann.com 456 (Chennai)

The High Court relied on the ruling in *Vodafone M-Pesa*[7], wherein it was held that it is not open to the Revenue to change the method of valuation which has been opted for by the assessee. It also relied on co-ordinate bench ruling in *Credtalpha Alternative Investment Advisors*[8] wherein it was held that that DCF method adopted by the assessee cannot be rejected merely on the basis of comparing projections with actuals.

ITAT observes that the DCF method is one of the prescribed methods provided in Rule 11UA of the Income-tax Rules and Assessee is given an option either to use the DCF method or NAV method. Unless assessing officer points out any error in the computations under DCF method, such valuation cannot be rejected.

Katalyst Comments:

Where option to the assessee has been given to undertake valuation as per method of its choice, revenue authorities should not challenge the same; the larger issue is that this provision is an outlier provision and has created huge litigation which is clearly adverse to ease of doing business.

B. Corporate Law Highlights

1. Bangalore NCLT approves Merger of 3 companies with 2 different appointed dates for each Transferor Company

In a scheme of arrangement for merger involving three companies[9], the appointed date for Transferor company 1 and Transferor Company 2 were different. The Regional Director had sought explanation for the rationale on having two different appointed dates for both the companies and had sought clarification on rationale for issue of shares at premium by the transferee company.

The Petitioner companies had submitted that the appointed dates were in compliance of General Circular 09/2019 and they were chosen for the reason that investments by transferor companies in the transferee company were acquired on a specific date, consequent to which appointed dates were chosen. It was also submitted that the consideration was based on valuation report issued by registered valuer. Considering these representations, NCLT approved the scheme of arrangement.

Katalyst Comments:

Sec. 230-232 of the Companies Act do not provide for any restriction w.r.t. appointed dates for the purposes of scheme of arrangement. As per MCA General Circular 09/2019, the appointed date for a scheme of arrangement should not be antedated more than 1 year from the date of filing of application. Petitioner Companies need to comply with this circular (which the

[7] [2018] 92 taxmann.com 73 (Bombay)
[8] [2022] 134 taxmann.com 223 (Mumbai - Trib.)
[9] Microin Services P. Ltd, CP(CAA)No.31/BB/2022, NCLT, Bengaluru, dated November 25, 2022

Companies in above case did comply with) or should explain the rationale for having appointed date antedated more than 1 year.

2. Delhi NCLT rejects scheme of arrangement seeking carry forward of losses u/s 72A upon objection of Income-tax Department

In a scheme of arrangement for amalgamation filed by Minda TG Rubber Private Limited[10], the petitioner companies had sought for carry forward of business losses and unabsorbed depreciation under Income-tax to the transferee company under the scheme.

The Income-tax department had objected to the approval of the scheme on the grounds that carry forward of losses and unabsorbed depreciation to the transferee company will result into loss of revenue to the Income-tax department.

NCLT observed that the petitioner companies had sought of carry forward of losses to the transferee company but had not provided for compliance to conditions prescribed u/s 72A (for carry forward of losses and unabsorbed depreciation under a scheme of amalgamation) of the Income-tax by the Transferee Company. As the scheme did not provide for specific compliance u/s 72A of the Income-tax act and considering objections of Income-tax department, NCLT rejected the scheme of arrangement for amalgamation.

Katalyst Comments:

This is one of the instances were the NCLT has evaluated compliance of the conditions of sec. 72A for the purpose of approving the scheme of amalgamation. The scheme filed under this case contained a clause for modification of the scheme to the extent necessary to comply with the provisions of the Income-tax Act, but seems to have been overlooked by the NCLT.

However, the objection raised by the Income-tax department with regard to loss of revenue on account of carry forward of losses appears to be totally unjustifiable, given that the Act permits for such carry forward of losses, subject to compliance of certain conditions, many of which can only be complied with in future. The NCLT view does not seem consistent with the intent of lawmakers while introducing such provisions granting exemptions, carry forward of losses, etc. since, in any case, the set-off of losses will depend on the compliance during the year in which set-off is claimed.

3. Supreme Court: Responsibility for pre-closing liabilities in a Business Purchase transaction on Seller[11]

The Supreme Court, in dispute relating to responsibility for discharge of tax liabilities (arising after closing date but relating to period prior to closing date) in transaction involving slump sale of undertaking has held that, where the agreements executed mentioned the confirmation by the Seller with regard to settlement of tax-liabilities upto closing date, the tax

[10] NCLT, Delhi Bench in the matter of Minda TG Rubber Pvt. Ltd. in CP (CAA) 118/ND/2021
[11] Wave Industries Private Limited vs State of Uttar Pradesh dated December 15, 2022

liability arising post-closing date but relating to pre-closing period should be discharged by the Seller and not the purchaser.

There was a transaction of Business Transfer by way of slump sale, in which the purchaser had acquired an undertaking from the seller by execution of slump sale agreement and property sale agreement. The Slump Sale agreement contained a clause that the contingent liabilities and pending legal proceedings in relation to the undertaking were transferred to the buyer except for certain excluded liabilities which were identified and retained by seller till signing date. The agreement also contained a confirmation from the seller that all tax liabilities relating to the Undertaking up to signing date had been settled by the seller.

Subsequently, tax liability arose in connection to the undertaking for a pre-closing period and the parties disputed the responsibility for discharging such liability, leading to filing of appeal before the Supreme Court, which held that the liability was to be discharged by the seller as it pertained to pre-closing period.

Katalyst Comments:

This judgement emphasizes on requirement to have specific terms with regard to pre-closing liabilities alongwith suitable indemnity clauses and not leave it to be mutually decided at the discretion of parties involved.

It is also important to take cognizance of this judgement from a taxation viewpoint, as a slump sale transaction requires transfer of business undertaking on a going concern basis along with all assets and liabilities.

4. MCA proposal for changes in the Insolvency and Bankruptcy Code:

MCA vide notice dated January 18, 2023 invited comments from public for proposed changes in the Insolvency and Bankruptcy Code, 2016; as mentioned below:

- Use of Technology in IBC Ecosystem;
- Changing process of admission of applications under CIRP;
- Empowering Adjudicating Authority to levy penalty for violation of code;
- Improving outcome in real estate cases
- Change in mechanism in approval of resolution plans
- Improving recoveries for operational creditors and statutory dues
- Recasting the liquidation process
- Improving regulatory process regarding service providers

Katalyst Comments:

IBC, 2016 has been an instrumental legislation for improving the economic and banking system of the country. However, there have been concerns about lesser positive resolutions and delays in admission and approvals of resolution plan. Addressing these issues, MCA has proposed changes in the IBC, 2016 and has invited comments from public thereon, which can be submitted till February 7, 2023.

C. FEMA Highlights

1. RBI guidelines on reporting in Single Master Form on FIRMS Portal[12]

RBI vide Circular No. 22 dated January 4, 2023 has notified for changes in reporting of Single Master Form (SMF) on Foreign Investment Reporting and Management System (FIRMS) portal. According to the said circular, forms submitted on the portal will be auto-acknowledged and the AD Banks shall verify the same within 5 working days based on the uploaded documents. In case of delayed reporting, the AD Banks shall either advise the Late Submission Fee (LSF) to the applicants as computed by the system or advise for compounding of contravention. Other changes include Communication of LSF, status of realisation of LSF and rejection of forms through system generated email and updation on FIRMS portal.

D. Securities' Law Highlights

1. Master Circular for Foreign Portfolio Investors, Depository Participants and Eligible Foreign Investors[13]

SEBI has released a master circular dated December 19, 2022 (in supersession of Operational Guidelines for FPIs, DDPs and Eligible Foreign Investors dated November 5, 2019); consolidating the guidelines as per SEBI (FPI) Regulation, 2019 and subsequent circulars therein. Consequently, 115 circulars issued by SEBI since 2001 stand rescinded.

Katalyst Comments:

With increase in delegated legislation in the governance framework at present times, such consolidated master circulars are a welcome step in easing regulatory compliance and bringing out clarity in applicable framework.

2. SEBI Circular on comprehensive framework for Offer for Sale (OFS) of shares through stock exchange[14]:

SEBI has notified a comprehensive framework for Offer for Sale of shares according to which shareholders of eligible companies (companies having market capitalisation of more than INR 1000 crore as average daily market cap for last 6 months prior to OFS) will be permitted to sell shares through OFS route. The minimum size of OFS should be INR 25 crores, unless such OFS is by Promoter or group entities to achieve minimum public shareholding in a single tranche.

This circular shall be applicable with effect from February 8, 2023.

[12] RBI Circular A.P. (DIR Series) Circular No. 22 dated January 4, 2023
[13] SEBI Master Circular dated December 19, 2022
[14] SEBI Circular No. 2023/10 dated January 10, 2023

E. Demonetisation:

1. SC upholds legality of demonetisation carried out by Notification u/s 26(2) of RBI Act without passing legislations like on earlier 2 occasions[15]

Demonetisation of Rs. 500 and Rs. 1,000 notes was announced by the Government on November 6, 2016, by issuing notification u/s 26(2) of the Reserve Bank of India Act, 1934 ('RBI Act'). Several writ petitions challenging the policy of Demonetisation were filed before the Supreme Court and also before various High Courts, and the matter was ultimately referred to a 5 judge bench. The Demonetisation meant that these notes would cease to be the liability of the RBI u/s 34 of the RBI Act and would cease to have the guarantee of the Central Government u/s 26(1) of the Act. The Demonetisation was challenged on various grounds; the petitioner was represented by Mr. P. Chidambaram, Mr. Shyam Divan and Mr. Prashant Bhushan amongst others, whereas Union of India was represented by R. Venkataramani, Attorney General and Senior counsel Jaideep Gupta, represented the RBI.

Several technical arguments were made by the petitioner and the key arguments were as follows:

- The powers of demonetisation and recommendation should have emanated from RBI, whereas in this case, it emanated from the Central Government.
- RBI did not apply its mind to the matter and was not given time to do so.
- The overall decision making process was deeply flawed.

The matter was held in favour of the Government, but there was a dissenting judgement by Justice Nagarathna on several grounds, including the following:

- There is no ambiguity that the proposal for demonetisation originated from the Central Government.
- The power given to do a certain thing in a certain way must be done in that way or not at all and in this situation, it was not done in the way it should have been done.
- Decision is irreversible and hence one has no choice but to accept it.
- No time was given to RBI to apply its mind.
- When an authority exercises the discretion vested in it by law at the behest of another authority in a specific matter, this would in law amount to non-exercise of its discretionary power by the authority itself, and consequently, such action or decision is invalid

Accordingly, whilst demonetisation did happen in 2016 already and no relief can be granted as such, the dissenting judge held that the demonetisation was unlawful.

F. Goods and Service Tax highlights

1. Right to use car parking space is liable to GST @ 18% and not at 12%

West Bengal[16]AAR has ruled that supply of services of right to use 'car parking space' is not covered under the composite supply of construction of residential apartment services and

[15] Vivek Narayan Sharma versus Union of India dated January 2, 2023
[16] In the matter of Eden Real Estates Pvt Ltd. [TS-707-AAR(WB)-2022-GST]

hence, benefit of 1/3 abatement for land is not available and liable to GST at 18%. The AAR has also clarified that the taxability of providing of car parking space will not change even if the customer has opted for car parking space after receipt of completion certificate.

Katalyst Comments:

The West Bengal AAR has given a different ruling in similar case. The West Bengal AAR, in case of ***Bengal Peerless Housing Company***[17] *has held that the benefit of 1/3 abatement of land is available to the services of right to use car parking space and applicable GST rate is 12%.*

2. Karnataka High court allows the benefit of circular providing amendment in GSTR-1 for bonafide error of GSTIN mis-match

With respect to a writ petition filed by the assessee, the Karnataka High court has allowed the benefit of circular no. 183/15/2022-GST which permits amendment in GSTR-1 if the error occurred due to bonafide reasons, unavoidable circumstances and for sufficient cause. The High court clarified that the error of mis-match of GSTIN is a bonafide-error and the benefit of amendment in GSTR-1 should be extended to F.Y.2019-20 by adopting a "justice-oriented approach" although the circular is applicable to F.Y.2017-18 and F.Y.2018-19 only.

Katalyst Comments:

A welcome decision by the Karnataka High court. The circular provides for amendment of GSTR-1 in case of bonafide errors and if the GSTR-1 is amended to correct GSTIN, the ITC, which otherwise is not available due to mis-match can be claimed.

3. Renting of residential dwelling to a registered proprietor for personal use is exempt from GST

The Government has amended exemption notification to provide that the services of renting of residential dwelling to a registered proprietor for personal use and not for his business use is exempt from GST w.e.f. January 1, 2023.

Katalyst comments:

Before amendment of exemption notification, the services of renting of residential dwelling to a registered person was taxable under RCM w.e.f. July 18, 2022. Post this amendment, the Delhi High court in case of Seema Gupta vs. UOI has held that renting of residential dwelling to a registered proprietor for personal use is exempt. The amendment in exemption notification by the Government is in line with the Delhi High court decision.

[17] 2019-TIOL-137-AAR-GST

4. **GST is not applicable on incentive paid by MeitY (Ministry of Electronics and Information Technology) to acquiring banks for promotion of RuPay Debit Cards and low value BHIM-UPI transactions**

   The Government has issued a circular to clarify that incentive paid by MeitY to acquiring banks for promotion of RuPay Debit Cards and low value BHIM-UPI transactions is in nature of subsidy and linked to the price of service. Further, the same is not consideration for service supplied by acquiring banks to the Government and hence, no GST is applicable on such incentive.

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